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SUBJECT: ROMANIA: ECONOMIC OFFICIALS PRIVATELY AGREE IMF PROGRAM ADVISABLE

REF: 08 BUCHAREST 1016

Classified By: Charge d'affaire Jeri Guthrie-Corn for reasons 1.4 (b) and (d).

¶1. (C) Summary. Both the new State Secretary for budget issues at the Ministry of Finance (MOF), Gheorghe Gherghina, and the Prime Minister's new Economic Advisor, Ionut Popescu, told EconCoun this week that they believe a standby agreement with the IMF is advisable sooner rather than later, given the gloomy outlook for the Romanian economy. However, such an accord has little public or political support at present, making forward progress difficult. Neither Gherghina nor Popsecu expected significant modifications to the government's 2009 budget proposal, which is being debated this week in Parliament. Responding to Embassy concerns over effects of the budget squeeze on U.S. companies, Gherghina said the Government of Romania (GOR) is making a concerted effort to resolve long-delayed payments to U.S. contractors and hopes to substantially clear the backlog in VAT reimbursements by the end of next month. However, both Gherghina and Popsecu said that PM Emil Boc had caved in to strong pressure from trade unions on social security financing by freezing GOR contributions to private pension plans, and that despite complaints from post and prominent EU embassies, as well as from AIG and the other companies in the pension market, the freeze was unlikely to be overturned this year. Popescu admitted that the baseline economic assumptions on which the GOR based its 2009 budget are unrealistically upbeat compared to those of most private sector analysts, and that the bleak economic outlook would likely force the GOR to revise the budget downward within 2-3 months. End Summary.

¶2. (C) Both Gherghina and Popescu agreed on the advisability -- and eventual necessity -- of an external financing agreement, very likely to include a standby agreement with the IMF. However, both made a point of saying that this was a personal opinion and that the Government was not yet decided on this matter. According to Gherghina, MOF believes that banks, although not necessarily the GOR, would start to experience problems rolling over Lei-denominated debt in the next 4-5 months, making a precautionary arrangement with the IMF advisable, even if for no other reason than to restore confidence in the market. Reflecting on his term as a former Finance Minister, Popsecu noted that he thought that it had been a mistake for the GOR to give up its previous agreement with IMF, but that one is needed now to help calm the market and reassure investors. Popescu also admitted that with both political leadership and public opinion opposed, it is an uphill battle convincing others in the GOR to open negotiations with the IMF. This is a danger in that Romania could be forced into an agreement when the situation becomes truly dire rather than proactively seeking help now, he noted.

¶3. (C) On the recently submitted budget, Gherghina expected no significant modifications by Parliament, though he did say that there was pressure to expand funds dedicated to health insurance and research. Likewise, Popescu agreed that the budget would largely pass unmodified, but he foresees that an early budget revision (perhaps as soon as April) will be required to cut spending further as the economy slows. When asked where such cuts would come from, Popescu speculated that trimming public sector employee bonuses, freezing wages, and leaving vacant positions unfilled would not be enough, and the GOR would have to start laying off significant numbers of workers. While Gherghina did admit that MOF had prepared a more pessimistic set of budget assumptions (its "Plan B") in case economic growth was below the official target, these numbers still assumed positive growth and a government deficit of not more than 2.8 percent of GDP. For his part, Popescu found the "Plan B" scenario still too optimistic; he predicted zero or slightly negative GDP growth this year and significant spending cuts in the second quarter to try to keep the deficit within manageable limits.

¶4. (SBU) EconCoun pressed both officials to mitigate the negative impact on U.S. companies of the GOR's budget troubles, particularly by paying arrears owed to U.S. contractors and refunding long-overdue VAT reimbursements. While assigning the blame for these problems to the previous Tariceanu Government, both Gherghina and Popescu agreed with EconCoun that this issue needed to be resolved quickly in order to maintain the confidence of foreign investors. Gherghina asserted that he had taken a proactive approach by ordering a review of unpaid invoices, and was surprised to

find some that were over 1,000 days old. He told EconCoun that he was sending audit teams to check overdue invoices with an eye toward resolving any difficulties and paying them immediately, and that new Finance Minister Pogea had repeatedly raised this issue with his counterparts at other Ministries. Saying that the former government appeared to have tried to "break the deficit" by withholding VAT refunds, he said that this practice had ended and that his goal was to have all overdue refunds paid by the end of March at the latest. Gherghina seemed surprised to learn that many companies have complained about difficulties in obtaining responses from working-level MOF staff. He promised to address customer service issues and invited post to bring future such concerns to his personal attention.

¶5. (SBU) EconCoun provided both Gherghina and Popescu a copy of a February 10 letter to PM Boc signed by the Charge, in conjunction with the Dutch, Italian, German, and British Ambassadors, protesting the GOR's decision to freeze 2009 contributions to the mandatory "pillar two" private pension funds at the current 2.0 percent level, rather than increasing them to 2.5 percent as stipulated in the national pension law. (Comment: Under Romania's revised pension system, pillar one refers to traditional GOR-funded pensions; pillar two combines the traditional pension with worker and state contributions to individual retirement accounts, administered by private fund managers and largely invested in government treasuries; and pillar three consists of optional retirement accounts invested, for the most part, in the Romanian stock market. End Comment). The freeze is a priority concern for the association of private pension fund managers, which includes U.S. company AIG. The firms worry that the reduced contribution this year will not only prolong the already lengthy break-even horizon on their investment, but will also undermine confidence in the private pension system by establishing a troubling precedent that the terms of the system are subject to the annual budget whims of the Government and not to the law itself.

¶6. (SBU) Both Gherghina and Popescu acknowledged that the amounts the GOR would save through the freeze were relatively small, but said that the trade unions remain implacably

opposed to private pensions and had demanded the measure as a tradeoff for accepting the GOR's proposed 3.3 percent hike (2.3 percent from employers, 1.0 percent from employees) in social security taxes. Popescu explained that the Finance Minister had fought a losing battle to maintain the 2.5 percent contribution, but that a "political decision" had been taken to cede to the unions, in part to avoid potential labor unrest. While Gherghina held out a small hope that additional discussions may result in a reversal of the decision, Popescu categorically stated that would not happen this year. In fact, both Popescu and Gherghina noted that the trade unions had reintroduced a proposal, defeated last year, to require private pension fund managers to guarantee an annual rate of return at least equal to the rate of inflation, a measure which, if passed, would effectively end the private pension experiment in Romania.

¶7. (C) EconCoun also queried Popescu regarding progress in accessing EU structural funds and the internal dynamics within the PSD-PDL coalition. Popescu expressed frustration that more had not been done on accessing EU structural funds under the previous Government. He said that PM Boc has set up an inter-ministerial working group to focus on the issue, and that Boc himself attends these meetings on a bi-weekly basis to try to identify and resolve any roadblocks. However, Popescu noted that most of the funds are targeted at localities, which often lack the administrative savvy to take advantage of them. A major hindrance was the lack of technically competent local officials able to fill out and implement an EU grant. Another major deterrent is that EU funds often require 10-25 percent co-financing for projects up front, but the financial downturn has made obtaining credit for this purpose much more difficult. On the coalition, Popescu shared the consensus view that it is functioning surprisingly well ("much better than I personally expected") and would almost certainly hold together through European Parliament elections in June, if not the Presidential election later in the fall. Echoing the opinion of other interlocutors, he noted that the coalition as currently crafted is a very delicate balance, one which would likely collapse if either the PSD or the PD-L were to lose significant ground in public opinion surveys as elections approach.

¶8. (C) Comment. Gherghina and Popescu are both "re-treads"

from previous governments and have solid, and only mildly partisan, economic credentials. Their straightforward analyses offer a refreshing change from the sometimes off-the-cuff economic pronouncements of the prior Government, but it is clear that the political balance of economic policymaking has still not tipped entirely in these technocrats' favor. Political considerations and the relative balance of power remain at least as important as competently managing a deteriorating economic situation. During the visit, Gherghina received a call from Finance Minister Pogea, and in whispered tones insisted to an apparently reluctant Pogea that he really was expected to appear in Parliament that day to answer questions about the budget and could not skip out on this duty or pass it to the Prime Minister. Gherghina also noted it was he, not Pogea, who had introduced important MOF proposals in Boc Cabinet meetings. Ghergina, who comes from the PSD and occupied the same State Secretary position from 2001-2004, appeared to have a political minder at the PD-L-dominated MOF in the guise of an administrative assistant, who sat in on our meeting and furiously scribbled notes whenever Gherghina said anything even slightly controversial. Still, the presence in the new GOR of competent economists like Gherghina and Popescu does not necessarily translate into good fiscal policymaking, even in a crisis. Both interlocutors had a hand in crafting the budget, but were surprisingly honest in acknowledging that it will be obsolete almost as soon as Parliament approves it. End Comment.
GUTHRIE-CORN